



ARIZONA STATE SENATE
Fifty-Second Legislature, Second Regular Session

FACT SHEET FOR S.B. 1428

PSPRS modifications

Purpose

Subject to a conditional enactment, provides numerous changes to the Public Safety Personnel Retirement System (PSPRS) statutes, including establishment of a new defined contribution plan (DC), changes to its defined benefit (DB) system and changes to the PSPRS Board of Directors (Board).

Background

Laws 2011, Chapter 357 made numerous changes to the PSPRS. Among these changes were reducing permanent benefit increases and increasing employee contribution rates. The Arizona Supreme Court, however, ruled in *Fields v. Elected Officials' Retirement Plan* that the reduction of PBIs for current retirees violated Article 29 of the Arizona Constitution, which specifies that "public retirement system benefits shall not be diminished or impaired." This ruling reinstituted the pre-Chapter 357 PBI mechanism, which requires that whenever the annual investment earnings from the fund exceed 9.0 percent, then half of those annual excess earnings are transferred to a PBI reserve account. The annual PBI is then provided from that account in an actuarially determined amount up to a 4 percent increase. This ruling also applied to PSPRS and CORP retirees. PSPRS staff estimates that the *Fields* ruling has increased unfunded liabilities for all systems by \$1.8 billion.

Chapter 357 also modifies the PBI structure for PSPRS, CORP and EORP for members hired after the enactment. This law allows for a PBI only if the fund has annual investment earnings in excess of 10.5 percent and the overall funded status is at least 60 percent. The amount of the PBI would be between 2 percent and 4 percent, depending on the funded status of the plan. Chapter 357 would have limited the PBI to the amount of earnings in the fund that exceed 10.5 percent. Any excess earning amount that was not used for a PBI in a given year would revert back to the fund balance instead of remaining in a separate account.

Hall v. The Elected Officials' Retirement Plan litigates the increased contribution rates for members who were active prior to the enactment of Laws 2011, Chapter 357. Chapter 357 raised the contribution rates for active members of CORP, EORP and PSPRS. The plaintiffs argued that statutory rates reflected a contractual agreement that could not be modified without employee consent. In July 2013, the Maricopa County Superior Court ruled against EORP and decided that Chapter 357 applies only to members of EORP who joined the system after the enactment of Chapter 357. The ruling effectively blocks PBI changes from being applied to active members hired before Chapter 357. The ruling was appealed and will be heard by an appointed five-person panel of lower-court judges in February 2016.

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Because of the complexity of the foregoing legislation and court cases, S.B. 1428 has numerous requirements for differing sets of participants who join PSPRS on differing dates. These dates are described in the provisions as Tiers 1, 2 and 3 and the applicable dates are as follows:

<i>Tier</i>	<i>Employees Hired</i>
1	Before January 1, 2012
2(a)	Members with less than 20 years of credited service before 1/1/2012
2(b)	January 1, 2012 – June 30, 2017
3	July 1, 2017 and thereafter

Provisions

Tiers 1 and 2 – COLA/PBI

(Conditional on passage of S.C.R. 1019 at special election on May 17, 2017)

1. Repeals current statute referencing the permanent benefit increase and establishes a new cost of living adjustment (COLA) structure.
2. States that each Tier 1 and 2 retired member or survivor of a retired member is eligible to receive a compounding COLA.
3. Bases the cost of living adjustment on the average annual percentage change in the Metropolitan Phoenix-Mesa Consumer Price Index, with the immediately preceding year as the base year for making the determination, not to exceed annually two percent of the retired member's or survivor's base benefit.
4. States that the COLA shall be made on July 1 each year.
5. Prorates the COLA in the first year of a member's retirement.
6. Requires the actuary to include the projected cost of providing the COLA in the calculation of normal cost and accrued liability.
7. Prohibits a participant from receiving the COLA during a deferred retirement option plan participation period.

Tier 3 – COLA/PBI

8. Entitles each Tier 3 retired member or survivor of a retired member to a compounding COLA, beginning the earlier of the first calendar year after the seventh anniversary of the retired member's retirement or when the retired member is or would have been 60 years of age.
9. Requires a COLA to be paid on July 1 of each year, for each Tier 3 member, when the funded ratio of Tier 3 members is 70 percent or more.

10. Limits the COLA, for a Tier 3 member, to not to exceed the following:

<i>Funded Ratio</i>	<i>Percentage of Base Benefit</i>
At least 90%	2%
More than 80% but less than 90%	1 ½%
More than 70% but less than 80%	1%

11. Requires the system actuary to include the projected cost of providing the COLA adjustment in the calculation of normal cost and accrued liability.
12. Defines *funded ratio* as the ratio of the market value of assets to the actual accrued liabilities.
13. Requires, for all tiers, that any future benefit increase adopted by the Legislature shall be fully paid in the year of enactment and may not be amortized over any period of years.
14. Requires that any benefit for Tiers 1 and 2 members shall be paid by the employer.
15. Requires that any benefit for Tier 3 members shall be split equally between the employer and the member.
16. Stipulates a method for the calculation of the benefit increase by the plan actuary.

Election of Benefits

17. Adds to the definition of *average monthly benefit compensation*, for Tier 3 employees, that the considered period is the 5 consecutive years within the last 15 completed years of credited service that yield the highest average.
18. Adds to the definition of *normal retirement date*, for a Tier 3 employee, the first day of the calendar month immediately following the employee's completion of 15 years of credited service if the employee is at least 55 years old.
19. Allows a Tier 3 employee to elect to participate in the PSPRS DB or DC plan.
20. Requires that participation in either plan will begin 90 days after the date of hire.
21. Requires the DB or DC election to be made before the 90th day of hire. If no election is made, the employee will be automatically enrolled in the DB plan for the remainder of the employee's employment.
22. Stipulates that the plan selection is irrevocable and will be the employee's election for the remainder of employment, regardless of whether the employee's employment is continuous.
23. Allows an employee to participate solely in the DB plan or to participate solely in the DC plan.

24. Requires an employee who selects the DB plan but is not covered by Social Security to also participate in the DC plan for any period that the employee is not covered by Social Security.
25. Prohibits that employee from making contributions to the DC plan if that employee becomes subsequently covered by Social Security. If at any time that employee becomes uncovered by Social Security, the employee shall again be required to contribute to the DC plan.
26. Stipulates that if an employee becomes eligible for an accidental disability pension during the employee's first 90 days of employment, the employee shall be automatically enrolled in the DB plan and shall receive an accidental disability pension.

Defined Benefit Plan (DB)

27. Excludes from participation in the PSPRS DB plan any Tier 3 employee who makes the irrevocable election to participate solely in the PSPRS DC plan and who was not an active, an inactive or a retired member of the system or a member of the system with a disability on June 30, 2017.
28. Implements a new 50/50 contribution rate for employer/employee, for Tier 3 members, as follows:
 - a) each employer shall make contributions sufficient under actuarial valuations to pay 50/50 of both the normal cost plus the actuarially determined amount required to amortize the total unfunded accrued liability for each employer attributable only to those Tier 3 members. For the purposes of determining an actuarial gain or loss, smoothed over a period not more than five years as determined by the Board, a new amortization base shall be created on a level-dollar basis over a closed period equal to the average expected remaining service lives of all members but not more than ten years; and
 - b) the remaining 50 percent of normal cost and the actuarially determined amount required to amortize total unfunded accrued liability shall be divided by the total number of the employer's Tier 3 members, such that each member contributes an equal percentage of the member's pensionable compensation.
29. Prohibits, for all tiers, an employer's contribution in combination with member contributions from being less than the actuarially determined normal cost. The Board may not suspend contributions unless both of the following apply:
 - a) the PSPRS actuary, based on annual valuation, determines that continuing to accrue excess earnings could result in disqualification of the PSPRS's tax-exempt status; and
 - b) the Board determines that the receipt of any additional contributions required would conflict with its fiduciary responsibility.
30. Stipulates that, for all tiers, the total liability associated with the member's service with the employer remains with the employer, if a member's employment is terminated with an employer by either party.
31. Limits, for Tier 3 members, the annual compensation of each member taken into account for purposes of PSPRS to \$110,000. Prohibits this limit from exceeding the maximum compensation limits adopted by the Internal Revenue Code.

32. Establishes a mechanism to adjust the pensionable pay cap. Requires the Board, beginning in FY 2021 and every third FY thereafter, to adjust the annual compensation limit by the average change in the public safety wage index. The Board shall annually publish the wage index in January.
33. Requires the Board to establish the public safety wage index that is composed of a group of employers that represent geographic diversity across this state. Provides specific employer and employer group requirements.
34. Prohibits the Board from changing the employers represented in the wage index more frequently than every ten years, unless required to maintain the composition of employers.
35. Stipulates that, for a Tier 3 member who retires on or after the member's normal retirement date, the member shall receive a monthly amount equal to the member's average monthly benefit compensation multiplied by the number of whole and fractional years of credited service multiplied by the following:

At least 15 but less than 17 years of credited service	1.5%
At least 17 but less than 19 years of credited service	1.75%
At least 19 but less than 22 years of credited service	2.00%
At least 22 but less than 25 years of credited service	2.25%
At least 25 years of credited service	2.50%

36. Requires that Tier 3 members who have earned at least 15 years of credited service may retire at age 52 ½ years old and will receive an actuarially equivalent retirement benefit.
37. Allows a Tier 3 member who attains a normal retirement date to receive a retirement benefit even if the member terminates employment with an employer before the age requirement for normal retirement if the member attains the credited service requirement for normal retirement. Once a member reaches the normal retirement age, the member may receive payments.

Defined Contribution Plan (DC)

38. Requires the Board to establish, design and administer a DC plan. Participants are eligible to participate in the DC plan beginning 90 days after the date the participant is hired.
39. Provides that a “*participant*” in the DC plan includes:
- a) a Tier 3 employee who makes the irrevocable election to participate solely in the DC plan and who was not an active, an inactive or a retired member of the DB system or a member of the DB system with a disability on June 30, 2017;
 - b) a Tier 3 employee who is not included in their employer's Social Security agreement, who makes the irrevocable election to participate in the DB plan or who is enrolled in the DB plan through default; and
 - c) a Tier 2(b) employee who is not covered by Social Security. (*The provision regarding a Tier 2(b) employee is conditional on passage of S.C.R. 1019 at special election on May 17, 2017*)

40. Provides that the Legislature intends that the DC plan be designed to be a qualified government plan under the Internal Revenue Code and be exempt from taxation.
41. Allows the Board to adopt additional provisions that are necessary to fulfill this intent.
42. Allows the Board to submit to the Internal Revenue Service (IRS) a request for a determination letter that it is a qualified plan. Also allows the Board to submit a request for a private letter ruling that all participant contributions that are picked up by the employer shall be treated as employer contributions.
43. Requires the Board to:
 - a) enter into a contract with a provider to provide fully-bundled retirement plan investment, plan administration and services to participants in the DC plan. Provides requirements for the contracting obligation;
 - b) require under the contract that the DC plan provide education, counseling and objective participant-specific plan advice to participants;
 - c) require under the contract that the DC plan include no less than 5 and no more than 15, predetermined investment portfolio options to participants. Includes requirements for these options; and
 - d) require under the contract that the DC plan offer participants a menu of lifetime annuity options, either fixed or variable or a combination of both.
44. Allows the Board to:
 - a) employ other services it deems necessary, including legal services; and
 - b) perform all acts, whether or not expressly authorized, that it deems necessary and proper for the operation and protection of PSPRS.
45. Requires the Board to participate in a competitive bid process at least once every five years to contract to administer the DC plan.
46. Requires that each Tier 3 participant in the DC plan shall contribute the following percentage of the participant's gross pensionable compensation by salary reduction that shall be deposited in the participant's annuity account:
 - a) 3 percent for a participant who participates in PSPRS's DB plan and is not covered by Social Security; and
 - b) 9 percent for a participant who participates solely in the DC plan.
47. Allows a participant to make a one-time irrevocable election before the participant is eligible to participate in any qualified plan of the employer to contribute more than the percentage specified, which shall be the participant's contribution rate for the remainder of employment.
48. Requires that all participant contributions made to the DC plan shall be picked up and paid by the employer in lieu of contributions by the employee. Allows these contributions to be made through a reduction in the participant's compensation.
49. Requires each employer to annually make a contribution equal to the following percentages of each participant's gross pensionable compensation:

- a) 3 percent for a participant who participates in PSPRS's DB plan and is not covered by Social Security; and
 - b) 9 percent for a participant who participates solely in the DC plan.
50. Prohibits a participant of the DC plan from taking loans on any portion of the accumulated assets in the participant's annuity account.
51. Requires each participant that participates solely in the DC plan and each employer to contribute to the disability program.
52. Requires that a participant's contributions and earnings are immediately vested. A participant is fully vested in the DC plan after ten years of service, with employer contributions vesting at a rate of ten percent per year.
53. Requires a Tier 2(b) participant in the DC plan to contribute three percent of the participant's gross pensionable compensation by salary reduction. Each employer of a participant shall annually make a contribution equal to the following percentages of the participant's gross pensionable compensation:

<i>For Employees Hired in</i>	<i>Percentage</i>
2012	4% for 7 years and 3% thereafter
2013	4% for 6 years and 3% thereafter
2014	4% for 5 years and 3% thereafter
2015	4% for 4 years and 3% thereafter
2016	4% for 3 years and 3% thereafter
2017, through July 1	4% for 1 years and 3% thereafter

(The provision regarding a tier 2 employee is conditional on passage of S.C.R. 1019 at special election on May 17, 2017)

54. Allows a Tier 2 employer, to choose to pay a portion of the participant's contributions in an amount of no more than the difference between the contribution rate under the DB plan for Tier 2(b) employees and any employee hired before 2012.
55. Allows a retired participant in the DC plan to opt in to the health and accident coverage established by the Department of Administration or the Arizona State Retirement System, but requires the retired participant to pay the premium for the coverage selected.

DC Disability Program

56. Establishes a DC disability program for participants in the DC retirement plan who have elected to participate solely in the DC plan.
57. Allows the Board to delegate authority to administer the program as it deems necessary and prudent.
58. Establishes the Disability Program Trust Fund (Fund) for the purpose of paying benefits under and costs of administering the disability program.

59. Requires that abandoned monies shall revert to the Fund under certain stated conditions.
60. Requires the Board to:
- a) account for the operation, administration and investment expenses and allocate them against investment income;
 - b) contract on a fee basis with an actuary to make an actuarial valuation of the program;
 - c) contract on a fee basis with an independent auditing firm to make an annual audit of the accounting records of the fund; and
 - d) invest the monies in the Fund as provided by statute.
61. Allows the Board to:
- a) employ services as it deems necessary;
 - b) either keep invested monies separate or commingle invested monies;
 - c) do all acts that may be deemed necessary or proper for the protection of the Fund; and
 - d) determine the rights, benefits or obligations of any person and afford any person dissatisfied with a determination of the person's rights, benefits or obligations with a hearing on the determination.
62. Requires all employers of DC only participants, beginning July 1, 2017, to contribute the percentage of the gross pensionable compensation of all participants under their employment so that the total employer contributions equal the amount that the Board determines is necessary to pay one-half of all benefits under the costs of the disability program.
63. Requires a participant, beginning July 1, 2017, to contribute a percentage of the participant's gross pensionable compensation equal to the employer contribution.
64. Requires the Board to allocate the contributions to the Fund and place the contributions in the disability program's depository.
65. Requires the Department of Administration and the Treasurer of each county and participating city and town to transfer to the Board the contributions provided within ten working days after each payroll date. Contributions transferred after these dates shall include a penalty equal to ten percent per annum, compounded daily, for each day that the contributions are late.
66. Requires the Board to return excess contributions to the employer if the employer requests return of the contributions within one year after the date of overpayment.
67. States that participant contributions are not refundable.
68. States that employer contributions shall be a percentage of pensionable compensation for each participant, as the system actuary determines, in an annual valuation performed as of June 30.
69. Requires that the total employer contributions shall be equal to the employer normal cost plus the amount required to amortize the past service funding requirement over a period consistent with generally accepted actuarial standards.

70. Requires the Board to follow the same procedures and method to determine eligibility for and continuation of a disability benefit as those used for the DB plan Tier 3 participant, reduced by an amount equal to the annuitized value of the participant's annuity account, not including a cost-of-living adjustment.

PSPRS Board and Advisory Committee

71. Increases Board membership, beginning January 1, 2017, from seven to nine members, and alters the Board makeup as follows:
- a) two members representing law enforcement, one of whom is appointed by the President of the Senate and one of whom is appointed by the Governor. A statewide association representing law enforcement shall forward at least three nominees for each position to the appointing officer. At least one of the members appointed shall be an elected local board member;
 - b) two members representing firefighters, one of whom is appointed by the Speaker of the House of Representatives and one of whom is appointed by the Governor. A statewide association representing firefighters shall forward at least three nominees for each position to the appointing officer. At least one of the members appointed shall be an elected local board member;
 - c) three members representing cities and towns in this state, one of whom is appointed by the President of the Senate, one of whom is appointed by the Speaker of the House of Representatives and one of whom is appointed by the Governor. An association representing cities and towns shall forward at least three nominees for each position to the appointing officer. These nominees shall represent taxpayers or employers and may not be members of PSPRS;
 - d) one member representing counties in this state who is appointed by the Governor. An association representing county supervisors in this state shall forward nominations to the Governor, providing at least three nominees for the position. These nominees shall represent taxpayers or employers and may not be members of PSPRS; and
 - e) one member who is appointed by the Governor from a list of three nominees forwarded by the Board. The Board shall select the nominees to forward to the governor from a list received from the advisory board of at least five nominees.
72. Requires the Board to select a chairperson from among its members each calendar year.
73. Allows a Board member to be reappointed. Any vacancy that occurs other than by expiration of a term shall be filled for the balance of the term. All vacancies shall be filled in the same manner as the initial appointment.
74. Allows a Board member to be removed only for cause by the appointing power or because the Board member has vacated the member's seat on the Board. A Board member who is removed for cause shall be provided written notice and an opportunity for a response. The appointing power may remove a Board member based on written findings that specify the reason for removal.

75. Stipulates that a Board member vacates the office if the member either is absent without excuse from three consecutive regular meetings of the Board or resigns, dies or becomes unable to perform Board member duties.
76. Stipulates certain qualifications for non-System members of the Board.
77. Prohibits a person who is an investment agent, broker or principal and is involved in securities or investments related to the Board's investments from serving on the Board.
78. Requires, for initial board appointments:
 - a) associations representing public safety personnel, cities and towns in this state and counties to establish a list of nominees who qualified and willing to serve on the Board. The list shall include at least three nominees for each position on the Board;
 - b) each member of the Board to be selected from the list of nominees presented to the delineated appointing elected officials for each position on the Board;
 - c) appointments to be made in a certain delineated order;
 - d) if these Board members are not appointed by November 1, 2016, the elected official who fails to make an appointment forfeits the appointment and the appointment will be made within 15 days by the next elected official in the rotation. This rotation shall continue until the eight Board members are appointed; and
 - e) staggered ending term dates for initial Board members.
79. Establishes a PSPRS advisory committee, beginning January 1, 2017, to serve as a liaison between the Board and the members and employers of PSPRS. The committee shall be appointed by the Chairman of the Board from names submitted by associations representing law enforcement, firefighters, state government, counties, cities and towns and tribal governments. Describes committee membership.
80. Requires that Board and other fiduciaries of PSPRS discharge their duties:
 - a) solely in the interest of the members and beneficiaries;
 - b) for the exclusive purpose of providing benefits to members and beneficiaries and paying reasonable expenses of PSPRS;
 - c) with the care, skill and caution that a prudent person acting in a like capacity would use;
 - d) impartially, taking into account any differing interests of participants and beneficiaries;
 - e) incurring only costs that are appropriate and reasonable; and
 - f) in accordance with a good-faith interpretation of the law governing retirement plans.
81. Requires a trustee to consider, when investing and managing assets, general economic conditions, the possible effect of inflation or deflation, the role each investment plays within the portfolio, the expected total return, needs for liquidity and the adequacy of funding based on reasonable actuarial factors.
82. Requires the trustee to diversify investments of PSPRS, unless the trustee reasonably determines that, because of special circumstances, it is clearly prudent not to do so.

- 83. Requires a trustee to adopt a statement of investment objectives and policies, including the desired rate of return, acceptable levels of risk from each asset class and asset-allocation goals. At least annually, the trustee shall review the statement or change or reaffirm it.
- 84. Allows an employer, member, beneficiary or fiduciary to maintain an action in which the court may award reasonable attorney fees and costs to either party, to enjoin an act, practice or omission, or for appropriate equitable relief to redress a violation.

Miscellaneous

- 85. Requires that when determining the unfunded accrued liability, all amounts be determined on a level percent of compensation basis for all employees of the employer who are members of the plan.
- 86. Requires PSPRS, within 15 days of the effective date, to commence a study to determine various methods in which risk pooling may be structured and local board consolidation and structure may be accomplished and to determine which methods, if any, are in the best interests of the PSPRS fund, members, beneficiaries and employers.
- 87. Requires the study to be presented to the PSPRS Board on or before January 15, 2017. The Board shall consider the study and report its recommendations for legislation to the President of the Senate, the Speaker of the House of Representatives and the Governor on or before February 15, 2017.
- 88. Contains an intent clause.
- 89. Contains a severability clause.
- 90. Provides technical and conforming changes.
- 91. Becomes effective on the general effective date or later, subject to the provisions of the conditional enactment.